of time and money gave them an economic interest in the coal in place and gave them the right to depletion based upon the payments which they received for the coal produced and delivered.

While the opinion of the Court does not expressly so state, it is apparent that the rationale of the decision of the Court of Appeals in the *Paragon* case is that a party who expends funds for the development or production of a mineral and must look to the mineral produced for the recovery of such expenditures and thereby assumes the risk that production may not be sufficient to pay the expenses has an economic interest in the mineral in place which is subject to depletion and that the payments which such party receives for producing and delivering the mineral is his gross income from the property for depletion purposes.

The material facts in the present case and in the *Paragon* case are basically identical. Richfield had no actual ownership of any portion of Petitioners' share of the oil in place and the Paragon operators had no actual ownership of any of the coal in place. Both Richfield and the Paragon operators incurred the expense and took the risk involved in producing the mineral. Neither Richfield nor the Paragon operators acquired ownership of the mineral produced as the result of the production.[4] Both Richfield and

[4]Richfield owned 70% of the oil because of its 70% interest in the lease and Richfield had the right to purchase Petitioners' entire share of the oil produced but did not acquire title to any part of Petitioners' share except by purchase.

the Paragon operators were dependent upon production for recovery of the expenses incurred by them.

The basic issue in both cases is whether the assumption of the risk and the expense of producing minerals which belong to another party gives the party who assumes such risk and expense an economic interest in the mineral in place and whether the compensation or reimbursement received by the party who assumes the risk and expense constitutes "gross income from the property" to such party or to the owners of the mineral produced, for depletion purposes.

The decisions of the Courts of Appeal in both cases are based upon principles which are contrary to the decision of this Court in *Parson v. Smith,* 359 U.S. 215 (1959), in which operators of coal property who assumed the expense and risk of production and were compensated on the basis of production were denied a deduction for depletion on the ground that they did not have an economic interest in the mineral in place.

Since the material facts and the basic issue in the present case are the same as the material facts and the basic issue in the *Paragon* case, it is respectfully submitted that the two cases should be heard and decided together in order to avoid further confusion in this very important field of law.

## CONCLUSION

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that, upon further consideration, a writ of certiorari issue to the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

BAYLEY KOHLMEIER,
*Counsel for Petitioners.*

November, 1964

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I, Bayley Kohlmeier, Counsel for Petitioners, hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay and that it is restricted to the grounds specified in Rule 58, Subdivision 2, of the Rules of this Court.

BAYLEY KOHLMEIER,
*Counsel for Petitioners.*

**(Appendix Follows)**

## Appendix

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 9179.

Robert Lee Merritt and Winnie Merritt;
G. Wesley Merritt and Fannie J. Merritt;
Jack D. Merritt and Willa Gray Merritt;
Virginia Bowling and Gladys Bowling, and
James O. Watson, 3rd, and Lucy J. Watson,
Petitioners,

*versus*

Commissioner of Internal Revenue
Respondent,

*and*

Commissioner of Internal Revenue,
Petitioner,

*versus*

Paragon Jewel Coal Company, Inc.,
Respondent.

ON PETITIONS TO REVIEW THE DECISIONS OF THE TAX COURT OF THE UNITED STATES.

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(Argued January 13, 1964. Decided March 17, 1964.)

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Before HAYNSWORTH, BRYAN and J. SPENCER BELL, Circuit Judges.

John Y. Merrell for Petitioners, Taxpayers; Michael Mulroney, Attorney, Department of Justice, (Louis F. Oberdorfer, Assistant Attorney General, and Lee A. Jackson and Melva M. Graney, Attorneys, Department of Justice, on brief) for Commissioner of Internal Revenue, and Frederick Bernays Wiener (Leroy Katz and Carl C. Gillespie on brief) for Respondent, Paragon Jewel Coal Co., Inc.

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J. SPENCER BELL, Circuit Judge:

These are consolidated appeals from the Tax Court. The issue is whether the lessee, Paragon Jewel Coal Company, Inc. [hereinafter referred to as Paragon], is entitled to the entire depletion deduction on the coal mined from its leased property or whether the several contract mine operators, petitioners in this action [hereinafter referred to as the operators], are entitled to a part of that depletion deduction based upon the amounts received by them respectively for the coal which each of them mined under agreements with Paragon. The Tax Court, which heard the cases together, decided that the lessee, Paragon, was en-

titled to the entire percentage depletion deduction. The operators appeal, contending that Paragon is required to share the deduction with them. The Commissioner, who took a neutral position as between the petitioners and Paragon before the Tax Court, appeals the decision in Paragon's case in order to protect his position as a stakeholder, conceding that either the operators or the lessee is entitled to the deduction, but not both.

Since the Commissioner concedes that either the operators or the lessee, Paragon, is entitled to the deduction, we find it unnecessary to go into all of the factual background, but shall confine ourselves to that part which we consider relevant to a decision of the issue between the parties. Paragon is the assignee of certain leases of coal bearing lands under which it has paid minimum royalties, tonnage royalties and land taxes. It has made substantial investments on the properties in order to prepare itself to process, ship and market the coal which was produced. Paragon's experience was as a processor and seller of coal rather than a producer; furthermore it lacked the capital to go into the producing end of the business. Rather than mine the coal itself, it entered into oral agreements with the petitioning operators and others to mine the coal by a method known as drift mining.[1] In addition to the equipment necessary

[1]Drift mining is done by driving a horizontal shaft into the hillside in order to extract the coal from seams which are usually less than three feet in thickness. The process is a difficult and economically marginal operation.

for storing and processing the coal, Paragon installed a road running around the mountain close to the outcrop line of the coal over which the coal could be trucked from the mines to Paragon's tipple, where Paragon cleaned, sized and sold the coal.

Beginning with the Stilwells in 1951 (who are not petitioners here), Paragon entered into oral leases with a number of operators, all of which were similar in terms. Under the agreement an operator would be allocated a specific surface area under which it might mine. The allocation was made either by pointing it out on the ground or by showing it to him on the over-all property map. The operator agreed to mine the coal within that area and deliver it to Paragon at the operator's own expense. All expenses of opening and operating the mines were borne by the several operators. Paragon agreed to pay a fixed price at the tipple, but it was understood that the price would, and in fact it did, vary with the market. The operators were required to use and pay for the services of Paragon's engineer and to operate and maintain their mines in accordance with state and federal regulations. The contracts were silent as to who was entitled to depletion. They contained no termination date and nothing was said between the parties on this subject. The Tax Court found that:

> It was anticipated by both parties that a contractor [contract mine operator] would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper

mining methods and produced coal meeting Paragon's specifications.

Because the contracts did not contain a specific statement that they were *not* terminable at the will of Paragon and because they did not contain a specific statement that the operator had a right or obligation to mine to exhaustion, the Tax Court concluded that as a matter of law the operators did not under the contracts have such rights.

We must disagree with the Tax Court's conclusions of law. Its own findings as to the intent of the parties quoted above negates its conclusions as to the legal rights of the parties under the contract. The parties contemplated that the operators would, and the evidence shows that they did, engage in large expenditures of time and money in preparing their respective sites for mining. We think the Tax Court was in error in concluding that because the oral contracts were silent on the point, the operators did not possess a non-terminable *right* to mine to exhaustion, especially in the face of the court's finding of an intent on the part of the parties to the contrary. It would be inequitable indeed to hold that Paragon might remain silent on this point until the operators had invested their time and money and then take the benefit of the operators' efforts at will and without cause. The burden was on Paragon to express the limitation, if any. *Jack's Cookie Co. v. Brooks,* 227 F.2d 935 (4 Cir. 1955), *cert. denied,* 351 U.S. 908 (1956). Paragon was under obligation to mine the

property. These operators were performing Paragon's obligation under its leases and this constituted ample consideration running from the operators to Paragon to make their mutual intentions with respect to the contract binding on Paragon. The fact that the contracts did not fix upon the operators an *obligation* to mine to exhaustion does not vitiate the binding effect of the intent of the parties to vest in the operators a *right* to mine to exhaustion. That the operators could cease mining would not destroy the mutuality. *Phillips Petroleum Co. v. Buster,* 241 F.2d 178 (10 Cir.), *cert. denied,* 355 U.S. 816 (1957).

Thus we see under this interpretation of the contracts, the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price. By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of *Parsons v. Smith,* 359 U.S. 215 (1959); *Elm Dev. Co. v. Commissioner,* 315 F.2d 488 (4 Cir. 1963); and *Stilwell v. United States,* 250 F.2d 736 (4 Cir. 1957).[2] The Tax Court's decisions are reversed and the cases remanded for entry of an order in conformity with this opinion.

*Reversed and Remanded.*

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[2]Indeed the *Stilwell* case arose out of the same facts, although of course the record being different, it is not *res judicata.*